



October 22, 2008

David W. Danner, Executive Director and Secretary  
Washington Utilities and Transportation Commission  
Post Office Box 47250  
Olympia, WA 98504-7250

Subject: General Rate Filing UW-081226, Response to Letter from Tom Miller

Dear Mr. Danner,

This letter is in response to the October 6, 2008 letter to you from Tom Miller, representing the Suncadia Residents Owners Advisory Committee.

This letter does not address Mr. Miller's request for reconsideration of the Commission's recognition of Suncadia's affiliated interest transactions included in the "no action" agenda of September 25, since that is a matter for the Commission and its staff to consider. Instead, we will respond to Mr. Miller's letter as it pertains to Suncadia's general rate case, which is currently pending before the Commission.

We will first respond to Mr. Miller's comments item by item, and then we will offer additional perspective about the intercompany dealings between Suncadia Water Company LLC and its parent company, Suncadia LLC.

### **Response to Specific Items**

1. *Lack of customer notice about the affiliated interest filing:* One of Mr. Miller's comments was that "the Company made its affiliated interest filing—which predetermines the cost of capital—with no notice whatsoever to Petitioners, and did so on a schedule designed to achieve 'no action' approval of the affiliated interest issues in advance of substantive discussion on the rate case."

*Response:* In making our affiliated interest filing, we simply followed the process set by the Commission. The Commission's procedures for affiliated interest filings do not require a customer notice, and we did not carry out such a notice.

However, we have been thorough and transparent in communicating with our customers throughout this rate review process. We have sent four notices to all of our customers over the past five months, beginning on May 15<sup>th</sup> with an eight-page document that explained in detail the upcoming changes in rates and the reason for them. We have made available to the Suncadia Residents Owners

Advisory Committee the detailed rate model upon which our rate request was based. We have met with members of the Committee and responded in writing to a lengthy list of questions. We have acknowledged, with appreciation, when Committee members caught an error in an earlier version of our rate model. We have been forthcoming about the reasons for any changes in the proposed rates as our request has made its way through the staff review process. We have fully demonstrated our commitment to public involvement in this process.

At the time we submitted our affiliated interest filing, the general rate case was scheduled for action by the Commission on September 25, the same meeting on which the affiliated interest filing appeared on the "no action" agenda. As it turned out, the general rate case was later postponed by Commission staff. In any case, the original timing had been coincidental. Since the affiliated interest filing is a separate matter, and its inclusion on the "no action" agenda does not restrict the Commission's ability to take affiliated interests into account as appropriate in the rate case, there is no need for the rate case and the affiliated interest filing to proceed together.

2. *Misrepresentation:* Mr. Miller's letter states that because Suncadia's initial filing should have occurred earlier than it did, that therefore "the Company cannot claim that the late 2007 loan document was not governed by the affiliated interest statute on the theory that it pre-dated WUTC regulation."

*Response:* The Company has not claimed that the late 2007 loan document was not governed by the affiliated interest statute; in fact, the late 2007 loan was explicitly identified in our filing as an affiliated interest transaction, and a copy of the loan document was attached to the filing. There is no basis for a claim of misrepresentation.

It is correct that our initial filing came after we had already crossed the 100-customer threshold, and we have acknowledged that fact in our dealings with the UTC staff from the very beginning. However, previous to regulation, customers were paying far less than the true cost of providing water service, as they are now under the current approved tariff. So the delay in the initial filing did not injure customers; rather, the delay benefited customers by prolonging the subsidy from the parent company.

3. *Lack of evidentiary support:* Mr. Miller states that the affiliated interest filing lacked evidentiary support.

*Response:* The evidentiary support for the reasonableness of the intercompany transactions is not only contained in the affiliated interest filing; it is also part of the UTC staff review of the general rate case.

The affiliated interest filing merely put on the record the formal documents that establish the affiliated interest transactions—in this case, a \$3 million intercompany note for debt financing and \$55,611 of intercompany reimbursements for accounting support, management time, and building rent. For the intercompany reimbursements, there was no formal document previously, so at the request of UTC staff, we created a notarized letter documenting the amount of the reimbursements and the basis for calculating them.

However, the scope of the UTC staff review of our general rate case includes the appropriateness of our intercompany transactions. Attached to this letter is a copy of our response to a request for information from the UTC staff; it provides more information about the basis for the intercompany reimbursements. The UTC staff also conducted an on-site review of the Company's infrastructure and financial records. The staff report on the general rate case will reflect the results of all of the staff research into this case.

### **Cost of Capital**

Since Mr. Miller's letter focuses on the cost of capital as a point of concern, we will provide more information about that subject.

#### *Debt*

The affiliated interest filing included \$3 million that Suncadia Water Company, LLC borrowed from its parent company, Suncadia, LLC. The promissory note extends until December 31, 2009. The parent company expects to renew that note annually until Suncadia Water's financial condition stabilizes and then convert the loan to a long-term loan with a fixed amortization schedule. The interest rate is adjusted annually to match the cost of the parent company's own revolving credit facility with U.S. Bank. At the time the initial interest rate was established for the promissory note, the parent company's credit facility costs included interest at the prime rate (then 5.25%) plus loan origination fees and other up-front closing costs that effectively added another .81% per year, resulting in the stated interest rate of 6.06%.

Over the past couple of months, the capital markets have been very volatile and the cost of credit, when available, has changed dramatically. The parent company just recently finished modifications to its credit facility with U.S. Bank. One of the changes was to the interest rate charged on the loan. The interest rate on this loan is now equal to the greater of (1) LIBOR (London Interbank Offered Rate) plus 4.5% or (2) 7%.. The parent company's current interest rate on the revolving credit facility is 8.22%. In January 2009, the interest rate on the promissory note will adjust to the then current interest rate (which will be at least equal to 7%). However, the rates proposed in this tariff continue to be based on a borrowing rate of 6.06%.

### *Equity*

The parent company's principal business is real estate development. Real estate development is inherently risky and, accordingly, investors in real estate development projects make their investments with the expectation of a return that is sufficiently high to compensate them for taking that risk.

We understand that the Commission's standard practice is to allow an equity return of only 12%. Accordingly, our rate model shows a 12% equity return for the Suncadia Water Company, LLC, despite that return being lower than the return that the investors in Suncadia anticipate to receive on their investment in the Suncadia project.

### *Summary - Cost of Capital*

Our understanding is that the UTC prefers a capital structure that is 60% equity and 40% debt. Our proposed structure for Suncadia Water Company, LLC is approximately 62% equity and 38% debt. We are proposing a 12% return on equity, even though it is lower than the return expected from the overall Suncadia development; again we have used this 12% return because that is our understanding that this is the percentage return on equity typically allowed by the UTC.

Our intercompany debt terms are also favorable to Suncadia Water Company, LLC. If Suncadia Water Company, LLC—a start-up utility company, with a small customer base and total revenue last year of only \$120,935—were to approach banks on its own and try to obtain a \$3 million loan with a rate of 6.06%, the results would be disappointing. In this case, the involvement of an “affiliated interest” has clearly lowered the cost of capital to Suncadia Water Company, LLC, resulting in access to capital and lower customer rates than would otherwise be possible.

### **Further Delay of General Rate Case**

Regardless of how the Commission decides to respond to Mr. Miller's reconsideration request, we ask that you not further delay the disposition of Suncadia's general rate case. Already the case has been delayed to a November 1 effective date, which means that the initial meter reading under the new rates must take place in the few days after November 1. Snow is already falling in the Cascades, and even a November 1 effective date carries the possibility that employees may have to clear away snow and ice to gain access to the meters. To delay the case further would make it even more difficult to take the initial meter readings under the new rates.

We first submitted our request for true cost-of-service rates to the Commission on May 16. During the five months since then, we have worked in good faith with both Suncadia homeowners and the Commission staff to provide information, conform to procedural

David W. Donner, Executive Director and Secretary  
Washington Utilities and Transportation Commission  
October 22, 2008  
Page 5

requirements, correct errors, and adapt our request in accordance with the staff's recommendations. We believe that further delays will not materially change the outcome, and that it is time to implement equitable rates that recover the real cost of providing water to Suncadia property owners.

Thank you for your consideration of these comments. Feel free to call me at 509-649-6352 if you have questions.

Sincerely,



Gary Kittleson  
Vice President, Director of Construction and Real Estate Finance  
gkittleson@suncadia.com

cc: Tom Miller

Enclosure: Response to Data Request #3



August 21, 2008

Mr. Jim Ward  
Regulatory Analyst  
Washington Utilities and Transportation Commission  
1300 S. Evergreen Park Drive, S.W.  
Olympia, WA 98504-7250

**RE:           Suncadia Water Company, LLC**  
**UW-081226**  
**Data Request 3**

Dear Mr. Ward:

This letter and attachments is in response to your Data Request #3.

1. Contractual services for \$13,522 and why this cost will be an ongoing cost for each year.

Attached is a detail of the costs included in Contract Services in 2007. Approximately \$8,485 of these costs are related to the water comprehensive plan update and \$3,953 are related to the water rate case filing. Both of these costs are probably more correctly classified as professional services and are discussed in Question 3 below.

That leaves a balance of about \$1,084. About \$551 of these costs are related to services for testing and a utility location notification service. The balance was related to snow removal. All of these costs will be on-going after 2007 and the snow removal costs will be substantially higher.

In 2007, most of the snow removal costs were paid by Suncadia and not passed on to Suncadia Water Company. Additionally, there are now more assets that require snow removal. Initially there was the reservoir road leading to the MPR reservoir and booster pump; now in addition there is Utility Complex 6 (potable booster pump) and the Tumble Creek reservoir road. Additionally, a new cost for 2008/09 winter season will be the cost of keeping fire hydrants cleared of snow.

So on a recurring basis, you have the two existing services of about \$600 per year plus an estimate for snow removal of \$8,000 - \$10,000 (of course dependent upon the severity of the winter).

2. Contractual legal for \$6,142 and why this cost will be an ongoing cost for each year.

Attached is a schedule that details the 2007 legal costs. Admittedly a portion of these costs are related to costs of getting the water utility up and running. It does seem reasonable that there will be some minimum level of legal services each year (customer collection issues, easements, miscellaneous agreements, etc.). Maybe an estimate of \$2,000 per year until we get a track record of these costs.

3. Professional fees for \$33,983 and why this cost will be an ongoing cost for each year.

Attached is a schedule that details the 2007 professional fees. And as mentioned above in Question 1, there is another \$12,483 of costs related to the water comprehensive plan and to the water rate case filing that probably were more properly recorded to this account.

Of the total \$33,983, \$25,589 is related to the water comprehensive plan update, \$5,744 related to the water rate case filing, and \$2,650 related to determining fire flows for residential builders (builders inquire as to the fire flow at building locations so they know how to size the required fire sprinkler system in the home).

The costs recorded to this line item currently are comprised of 3 principal activities: water comprehensive plan update, water rate case, and fire flow calculations.

- a. Water comprehensive plan update – this is an update required every 6 years; total estimated costs for this update is \$75,000, with the bulk of the spending happening in 2008; there will be several years without any cost for this activity, with the next update being 2013/2014.
- b. Water rate case filing – it is difficult to know how often rate cases will be filed; there may need to be one fairly quickly after this initial case once we have a full year of operating data. However, on a recurring basis after that, we may be able to assume a case every 2 to 3 years.

Similar to the water comprehensive plan, the bulk of this costs is

occurring in 2008. And this being an initial plan, the costs are much higher (approximately \$105,000 versus \$25,000-\$30,000 on subsequent submissions). We will probably have one year (2009) without costs and then costs in 2010 as we report on 2009 and possibly prepare a revised water rate case based on those numbers.

- c. The final activity was calculation of fire flows. As of right now, it appears that we have enough calculations to provide the answers needed by the designers/builders of new homes in the resort needing that data to properly design the required fire sprinkler systems. As the resort expands, there may be cost in the future.
4. Accounting cost for \$37,500 and why this cost will be an ongoing cost for each year.

The accounting costs reported in this account is the amount charged by Suncadia, LLC for the accounting services provided by Suncadia to Suncadia Water Company, LLC (as it does not have any accounting staff). Attached is a schedule prepared by Suncadia accounting showing the services provided, an estimate of the time spent, and the cost.

The financial model that accompanied the water rate case showed the hiring of an office/clerical employee by Suncadia Water. That person will pick up some of the functions currently performed by Suncadia accounting (specifically, billing and invoicing and assisting in responding to customer inquiries about account balances (this duty will continued to be shared with Suncadia accounting)).

The attached schedule shows that the value of the services provided by Suncadia accounting to be slightly more than the \$37,500 that was charged in 2007. The schedule also shows the value of the services after removing the duties absorbed by the Suncadia Water new hire, and this value is just slightly under the \$37,500 figure.

The table on the following page summarizes the information discussed above.



	2007	2008	2009 thereafter
	(no inflation; no adjustment for customer growth)		
Contracted services	13,522	10,600	10,600
Legal costs	6,342	2,000	2,000
Professional fees			
Water comp plan	21,637	42,500	0 Next cost 2013
Water rate case	9,696	95,300	0 Next cost 2010
Fire flow calcs	2,650	0	0
Accounting cost	37,500	37,500	37,500

Please let me know if you have any questions about any of the enclosed information.

Suncadia Water Company, LLC  
Contract Services  
2007

Cascade Analytical Inc	\$ 280.00	- coliform colilert - testing
W & H Pacific	681.74	- water comp plan
One Call Concepts, Inc	271.00	- NW Utility Notification Center - utility locates
Hubregtse, Louman & Assoc.	2,427.80	- water comp plan
ESM Consulting Engineers	4,900.88	- water comp plan
Goldsmith & Associates	475.00	- water comp plan
Financial Consulting Solutions Group	3,952.50	- rate case
Norm Cook Trucking	533.12	- snow removal at Utility Complexes
	<u>\$ 13,522.04</u>	

Suncadia Water Company, LLC

Lathrop Winbauer Harrell, Slothower & Denison LLP  
Hillis Clark Martin & Peterson LLP

\$ 300.00 - misc legal  
6,041.77 - asset transfers, service agreements, rate case

\$ 6,341.77

Suncadia Water Company, LLC

Finanacial Consulting Solutions Group, Inc	\$ 5,743.75	- water rate case
ESM Consulting Engineers, LLC	4,563.94	- \$2,650 fire flow calculations; balance water comp plan
W & H Pacific	23,675.39	- water comp plan
	<u>\$ 33,983.08</u>	

Accounting Costs monthly	\$ 3,125.00
Months in year	<u>12</u>
Annual Accounting Costs	<u>\$ 37,500.00</u>

	Hours	Qtr/Mo/ Wk	Annualize d Hours	Hourly Rate	Load @ 30%	Total hourly rate	Total Annual amount	
<b>AR</b>								
Invoicing (including stuffing)	13	Qtr	52	17	5.1	22	1,149	New hire for Water company will handle this
Posting Cash Receipts	8	Wk	416	18	5.4	23	9,734	Will continue to do going forward
Customer Service Calls - related to posting.	2	Wk	104	20	6	26	2,704	Combination of new hire for water company and accounting
Total AR Hours			<u>572</u>				<u>13,588</u>	
<b>AP</b>								
includes Data entry, check processing, PO's and research	10	Wk	520	18	5.4	23	12,168	Will continue to do going forward
Review and sign checks and aprons	4	Mo	48	36	10.8	47	2,246	Will continue to do going forward
Total AP Hours			<u>520</u>				<u>12,168</u>	
<b>Cash Management</b>								
Deposit Water checks	2	Wk	104	15.5	4.65	20	2,096	Will continue to do going forward
Cash Management reports & cash tracking	2	Mo	24	18	5.4	23	562	Will continue to do going forward
			<u>128</u>				<u>2,657</u>	
<b>General Ledger</b>								
Entries								
Month-end (all JE's and month-end entries and accruals)	12	Mo	144	36	10.8	47	6,739	Will continue to do going forward
Reconciliations - Bank	2	Mo	24	25	7.5	33	780	Will continue to do going forward
Reconciliations - other	4	Mo	48	25	7.5	33	1,560	Will continue to do going forward
Financial Statements & Review	3	Mo	36	36	10.8	47	1,685	Will continue to do going forward
Audit & Prep	15	Yr	15	40	12	52	780	Will continue to do going forward
Total General Ledger			<u>267</u>				<u>11,544</u>	
<b>Total</b>			<u>1,487</u>				<u>39,957</u>	Currently they are only paying \$37,500
<b>Items new hire to handle after hired</b>			<u>104</u>				<u>2,501</u>	
			<u>1,383</u>				<u>37,456</u>	